



National  
Foreign  
Assessment  
Center

APPROVED FOR RELEASE  
DATE: MAR 2004

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(b) (3)

[CIAEB 78-10271]

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## Italy: Likely Economic Consequences of Communist Participation in Government

Central Intelligence Agency  
National Foreign Assessment Center

June 1978

### Key Judgments

The present governing formula—a Christian Democratic (DC) minority government supported in Parliament by the Communists (PCI) and four minor parties—is likely to be reviewed after the presidential election in December. Political leaders will be under strong pressure to opt for some form of the Historic Compromise, a coalition including both the Christian Democrats and the Communists. This pressure would be intensified by any further gravitation of voters toward the two largest parties in the parliamentary elections expected in early 1979. If a DC-PCI coalition is formed, our analysis suggests:

- The Communists probably would have a heavy input into economic policy formulation.
- DC-PCI governments, like their predecessors, would have difficulty curbing labor costs and public sector spending.
- The economy would proceed in secular decline, punctuated by stop-go policy moves, should labor costs and public spending continue to soar.
- Failures in the economic area could cause the PCI to consider a return to the opposition and reassessment of strategy.
- Any economic achievements would tend to consolidate the DC-PCI alliance.

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## PREFACE

This paper attempts to indicate how the Italian economy would perform in both the short and medium terms under a DC-PCI government. We assume that in such a government or succession of governments Communist Party members would be excluded from sensitive portfolios—defense and foreign affairs—but would likely obtain economic posts. PCI input into economic policy would be considerable, partly for this reason and partly because of the strong economic orientation of the Communists. Other assumptions are as follows:

- The governmental partners would continue to operate within the existing framework of democratic institutions.
- A DC-PCI government would not abrogate Italy's international commitments—for example, Italy would remain in the European Community and would not renounce trade obligations of the General Agreement on Tariffs and Trade (GATT) or similar agreements.
- International creditors, both private and official, would not "red-line" Italy because of Communist involvement in the government.

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## Italy: Likely Economic Consequences of Communist Participation in Government

### Political-Economic Background

The political appeal of the Communist Historic Compromise proposal is remarkable considering it does not include any specific program. The Communists have merely stated a general notion that the two major parties would share the powers of government; they have never spelled out the policies such a government would implement or the goals it would pursue. The six parties that directly or indirectly supported the previous Andreotti government hammered out a programmatic accord last July in which general agreement was reached on a number of economic issues. Although the accord gave Andreotti a mandate for continued austerity and offered valuable insights regarding areas on which the DC and PCI could agree, it was too limited in scope to represent a workable program. Thus, in predicting what economic programs a Historic Compromise government would pursue, we must supplement what we know of the economic policies of both the DC and PCI with an estimate of their respective roles in a coalition.

[We expect that the Communists would gradually assume the upper hand in economic policymaking in a DC-PCI government. The Christian Democrats' ability to influence policy is limited by a lack of broadly agreed upon economic programs.] Split by factions on the left and right, the DC has frequently had trouble choosing between conflicting economic strategies espoused by its coalition partners. More often than not it has come down on both sides of the fence, so that government economic policies have been ineffectual compromises.

The Communist Party has a more consistent economic philosophy and clearer goals as well as an able staff of technicians. [And while the Communists would allow the Christian Democrats to retain their high priority security and foreign affairs posts] the PCI would almost certainly demand and get some important economic ministries. This would give the Communists a sound base from which to advance their ideas.

We recognize the inherent danger in weighting our estimates heavily upon the stated policies of the PCI. These policies are indeed subject to revision. Nevertheless, certain apparently significant consistencies run through the party's many public pronouncements on policy questions. Moreover, the PCI normally takes some time to condition its rank and file before making fundamental changes in the party line, although the PCI's discipline and organization do give it greater doctrinal flexibility than other parties have.

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At any rate, the PCI of the 1970s is not a Stalinist monolith. To some degree it must, like the DC, hold together persons of differing views and satisfy certain special interests. PCI leaders are constrained by the need to avert either a party split or a large-scale alienation of ordinary voters.

#### Policy Goals

The Communists have set economic stabilization as their initial policy goal. Hence they went along with, and indeed encouraged, the austerity programs instituted by the Andreotti government in 1976-77. PCI leaders would use conventional policy tools to check capital flight and control inflation. Party chief Enrico Berlinguer has worked long and hard to achieve his goal of Historic Compromise and is unlikely to undermine his position by championing reckless or radical action. While pursuing a moderate course, however, he must respond to the rising expectations of his party's base, particularly in the trade unions. To placate these groups, he is likely to hold out the prospect of income redistribution, expanded employment, and greater investment in schools, housing, hospitals, and transport facilities.

The PCI agrees with the DC on the need to avoid the large public sector deficits now looming and would work toward agreement on measures to strengthen the tax system. The Communists would press, as they have in the past, for higher direct taxes on individuals and tougher enforcement measures. Higher indirect taxes and increased public service charges also would be likely, given traditional difficulties in collecting direct taxes and persistent losses on public service activities. The DC may oppose the Communist push for greater reliance on direct taxes, a fairly tough set of tax measures is likely to emerge.

A Historic Compromise government would come up with programs similar to those of the center-left governments but would be more likely to carry them out. Communist proposals for infrastructure improvement in the areas of housing, public transportation, education, and health care all echo center-left sentiments and would require massive outlays. While we expect the PCI as a governing party would try to hold the line on new expenditures at first, party leaders would come under heavy pressure from below for increased social investment. The Communists have loudly advocated increases for years, deploring the failure of past governments to modernize Italy's socioeconomic infrastructure.

The Communists probably could not fulfill their promise to finance capital spending increases by trimming the bureaucracy and implementing governmental economies. Strong vested interests—particularly the DC interest in maintaining patronage—are likely to frustrate attempts at streamlining. Moreover, efforts to economize by releasing redundant labor from state enterprises or the bureaucracy would jeopardize Communist relations with the

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unions. The linkage of government transfer payments to the cost-of-living index will keep pulling current outlays up.

#### Relations With Labor

Ⓐ Historic Compromise government probably would ask for, and obtain, some concessions from organized labor. The PCI is well aware that the possibility it can deliver labor cooperation is the trump card in its political hand and would pressure union leaders for moderation. The duration of union moderation would depend in large part on the government's effectiveness in keeping promises on issues such as social investment, elimination of tax inequities, and protection of labor prerogatives and employment.

The PCI does not have absolute control over the Italian labor movement but, as the behind-the-scenes force in the largest of the three worker confederations, it has more influence in labor than any other political party. Since the mid-1970s, the PCI has more often than not used this position to encourage a cooperative union stance toward the government; the PCI-dominated confederation was instrumental late last year, for example, in getting the major labor organizations to propose an arrangement that amounts to a social contract in all but name.

Ⓐ government including the Communists just might stand more of a chance than its predecessors on the critical problem of soaring labor costs. The odds are better for obtaining union cooperation to reduce absenteeism and enhance worker mobility.

Any rapport developed with labor would be hard to maintain if, as seems likely, government-induced austerity led to further deterioration in the employment situation. Unemployment already is officially placed at about 7 percent. Since the late 1960s, Italian unions have become more sensitive to shop floor pressure and less inclined to accept guidance from parent political parties. This tendency is more pronounced in the Christian Democratic and Socialist unions than in the Communist ones, although many vocal Communist workers have become distrustful of a party leadership that they believe ready to subordinate bread-and-butter goals to questionable political ends.

A successful incomes policy would depend in large part on the realization of substantial changes in the wage indexation system—under which the wages of most industrial workers are automatically aligned with the cost-of-living index on a quarterly basis. Organized labor seems to regard this system as its most important single achievement. Although Communist economists apparently are convinced of the need to reduce the system's inflationary impact, they so far have been unable to gain much acceptance of that view within the labor movement. Any significant modification of the wage mechanism is extremely unlikely, unless the government can convince the unions that it is committed to and actively pursuing a full employment program.

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The urgency of the labor cost problem results from the steep rise in real wage rates of the last 10 years. Wage levels now appear to be approaching the area where additional increases can be achieved only at the cost of sharp declines in investment and employment. Top union leaders seem aware of this, but their apparent readiness to moderate wage demands and their ability to bring the rank and file along have yet to be tested in actual bargaining. Workers probably will blame the government—however constituted—for any leveling off of real wage rates or for the unemployment that big wage hikes could bring.

#### Role of the Private Sector

Infringements on the private sector by a Historic Compromise government are difficult to predict because PCI policy statements have been ambiguous (and keyed largely to public relations). On the one hand, the Communists stress the need for more centralized control over investment and employment decisions. On the other, they promise to maintain a vital private sector.

At the very least, we expect that government interference in the private sector would be increased under a DC-PCI government, continuing a trend begun under the center-left. The PCI initially would try to expand governmental control in three key areas—industrial investment, residential construction, and food processing. The inclusion in government of a party whose basic approach to the economy is essentially *dirigiste* and interventionist inevitably would lead to greater governmental influence over economic activity.

Large-scale nationalization of private industry is highly unlikely. The PCI has consistently rejected the idea of massive state takeovers, asserting that economic control can be achieved through coordinated economic planning and more efficient management of state-owned firms. Since state-owned firms are laden with DC patronage and burdened with severe losses, the PCI labels nationalization a discredited policy.

Nevertheless, the PCI—supported by the unions—would resist any effort to trim the state sector, which produces 9 percent of GNP and employs a 10th of the industrial labor force. The Communists undoubtedly regard the state sector as a potentially valuable politicoeconomic instrument and once in government would seek firm, consolidated control over it.

A Historic Compromise government is unlikely to threaten the continued presence in Italy of foreign-based multinational corporations. The Communists say vaguely that these firms must be watched. Once in power, they might demand that multinationals produce a larger proportion of their value-added in Italy.

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### The International Angle

The outlook for foreign investment in Italy under a Historic Compromise government is bleak. The importance of apprehensions about the Communists should not be exaggerated, however, since labor problems and low rates of return on equity already have made Italy a rather unattractive investment site. Foreign businessmen would remain extremely cautious about long-term commitments despite PCI assurances that repatriation of profits would be allowed to continue.

The enormous capital flight that many fear would follow Communist entry into government is unlikely to materialize. A larger Communist role has been anticipated for some time; the anxious already have had time to seek foreign havens for their funds. Moreover, during the past two years the government has enacted new controls that would dampen an upsurge in capital outflows. If a Historic Compromise government quickly announced a stabilization program—as seems likely—any financial panic probably would be short lived. If capital flows did become worrisome, however, a Historic Compromise government would quickly strengthen exchange controls further.

Communist involvement in the government should not represent an immediate threat to the policies or institutions of the European Community. The PCI has come to support EC integration, portraying a United Europe as an important counterbalance to both US and Soviet influence. Moreover, a large majority of the Italian public supports membership in the Community.

Eventually, however, the practical effect of trade policies, not ideological sentiment, would determine the impact of the Historic Compromise upon the Community. While the PCI presently eschews protectionist measures and party economists seem cognizant of Italy's vulnerability in a trade war, the Communist commitment to trade liberalism is a recent development. Protectionist sentiments remain strong within the party and among its labor supporters. On balance, we can say that a Historic Compromise government would be more likely to turn to protectionism than a government of the center-left. In any case, a Historic Compromise government probably would favor selective safeguard measures for threatened industries—steel, chemicals, and textiles—as a device for maintaining employment.

The Communists, supported by the other parties, would be likely to press for a revision in the EC Common Agricultural Policy in favor of Mediterranean agriculture. Communist farm policy seems driven by desire for agricultural self-sufficiency, and a Historic Compromise government would be likely to enact various farm subsidy measures. Such measures probably would run afoul of EC obligations.

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### Economic Prospects

(Chances are that a Historic Compromise government sooner or later would yield to working class pressure for big increases in both wages and public services. If so, labor costs and public sector deficits would continue or resume their rise, and the economy would flounder.)

(Real GNP growth would be unlikely to average more than 2 to 3 percent annually. Whenever the economy started to pick up steam, high and rising wage levels would lead to deterioration in the current account, and the government would respond by restricting demand. Restrictive demand management and the rise of real wage rates would inhibit private investment, quite apart from any investor skittishness regarding Communists in the government.)

(Rising unemployment, a natural concomitant of slow economic growth, would be the most disheartening feature of this scenario for the Communists. Inflation would be an intractable problem. Public expenditure would grow faster than total production on average, shifting more and more resources from private control to the public sector.)

### The Political Stakes

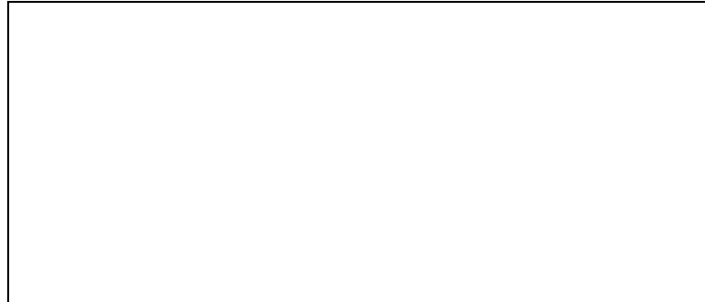
A Historic Compromise government would raise high hopes in Italy. Since it is widely perceived as the "last card" political leaders have to play—nearly all other constitutional variants having been tried and found inadequate—it would be given the benefit of the doubt by most Italians. Although such a government would not be expected to change everything overnight, it would be expected to register visible progress in the near term on at least some of Italy's more pressing problems. If it did so even in one or two areas, say housing and education reform, many Italians would think the DC-PCI alliance was off to a promising start and view it as an improvement over most of the coalitions and minority governments that preceded it. And a Christian Democratic - Communist partnership that showed signs of making a real dent in Italy's problems could endure in one form or another for years.

Both the Christian Democrats and Communists would face unpleasant choices if the Historic Compromise failed to live up to expectations. Although the Communists would probably try to blame Christian Democratic "immobilism," a poor performance by a Historic Compromise government would nevertheless tarnish the self-promoted PCI image as an efficient, innovative, and dynamic party.

(Faced with that prospect, the PCI would have to weigh the pros and cons of staying in the government. Although some Communists would doubtless argue that the party should stay in and seek ways of circumventing complications posed by existing institutions, the prevailing view would probably be that the party should return to the opposition and reassess its strategy.)

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